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LAW BULLETIN

Consequential losses — a can of worms for alliances

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contents

Many alliance projects are intrinsically complex and present high risks to the participants and, just as importantly, to other stakeholders and third parties.

Unfortunately, in preparing project documentation, too many alliances are giving too little attention to the treatment of potential claims by third parties arising from alliance activities.

The starting point — 'no blame'

Many alliance participants assume that the inclusion of a no-blame principle in their alliance agreements is the complete protection required by their corporate masters.

Not so.

A typical no-blame clause is along these lines:

> We agree that any act or omission of an Alliance Participant in performing the work under our Alliance Agreement which:
>
> (a) amounts to Wilful Default or an Act of Insolvency will give rise to enforceable obligations at law and/or in equity; or
>
> (b) does not amount to a Wilful Default or an Act of Insolvency will not give rise to any enforceable obligations at law or in equity;
>
> and we agree to release each other from any effects at law or in equity of any act or omission in performing our obligations under our Alliance Agreement that do not amount to a Wilful Default that we may have had but for this No Dispute clause.[1]

A no-blame covenant along these lines certainly means that, in the absence of wilful default or insolvency, no alliance participant can sue another participant for loss they suffer from alliance activities. So, for example, an owner cannot claim any financial losses it suffers from late completion or lack of fitness for purpose from the other participants.

Many agreements are not clear as to whether these losses are 'owner alliance costs' and are to be brought to account in assessing performance against the target cost estimate (TCE). However, the worst case for a non-owner participant is that the owner's losses are treated as alliance costs and effectively become a shared cost through the operation of performance adjustments, and are subject to the 'downside pain' cap.

But what about loss suffered by a non-alliance or third party? The no-blame clause certainly does not bind third parties and cannot prevent them from bringing claims against *any* of the alliance participants.

Injury and property damage

Generally, claims by third parties for death, injury and property damage arising from alliance activities will be covered by the project's public liability insurance.

Information contained in this newsletter is current as at January 2007

LexisNexis® Butterworths

As with construction projects generally, public liability insurance cover extends to all project participants and there is little need for either the participants or the insurer to be particularly concerned about the respective contributions to liability of any of these parties.

However, the policy will not respond in some circumstances:

- where the loss suffered by the claim occurs after the policy expires (normally at practical completion, with limited cover stretching into rectification periods); and
- where the policy excludes the claim (for example, many policies exclude cover where the cause of the accident was defective design).

Most alliances now deal with these circumstances by 'carving out' from the no-blame principle liability for death, injury and property claims by third parties.

For example:

> (a) Each Participant (the Indemnifier) agrees to indemnify each of the other Participants (each an Indemnified Participant) against:
>
> (i) claims by a third party; and
>
> (ii) liability to a third party,
>
> for damages to property or death or bodily injury arising out of or as a consequence of any act, error or omission of the Indemnifier in the performance of its Work under the Alliance whatever the cause, including breach of this Agreement, tort (including negligence) or breach of statute or otherwise.
>
> (b) The Indemnifier's liability to indemnify an Indemnified Participant under clause (a) shall be:
>
> (i) reduced proportionately to the extent that an act or omission of the Indemnified Participant, or its employees or agents, contributed to the loss or damage suffered by the Indemnified Participant or the claim or liability to the third party; and
>
> (ii) limited to the amount which is paid or payable to or on behalf of the Indemnifier under insurance held by the Indemnifier.

A clause along these lines preserves access to all non-alliance public liability insurance policies held by the participants (including the public liability component of a professional indemnity insurance policy).

The cross-indemnities also ensure that each participant can be sued for contribution by a participant who is sued by the third party.

This regime is consistent with proportionate liability legislation recently introduced across Australia. That legislation is dealt with in more detail below.

One question which often is not specifically addressed in the alliance agreement or alliance commercial discussions is who should take the risk of the various insurance policies not responding. Implicitly, the answer is that the alliance takes the risk, but only up to the cap on pain share. After that cap has been reached, the risk transfers to the owner solely.

Perhaps that is an appropriate outcome, but it is one that needs to be discussed and agreed, rather than being a default outcome because it has not been consciously addressed by the participants.

Third-party financial losses

The cross-indemnities for injury and property damage do not usually extend to third-party claims for financial losses. For example, an adjacent landowner may claim for loss of business revenue because of alliance activities.

Generally, that is because public liability policies do not respond to financial loss claims and access to insurance is generally the primary driver behind the carve-out.

So, even if the carve-out is extended to financial losses, the usual limitation of the operation of the clause to available insurance poses a significant issue where no such insurance exists.

In those circumstances, the no-blame principle prevails and a participant who is sued by a third party for financial loss cannot seek any contribution or indemnity from any other participant irrespective of who may have been at fault.

The risk can be partly mitigated by a 'first party' professional indemnity policy which covers all alliance participants for claims by third parties for losses arising from design and professional negligence; however, that

type of policy will not extend to construction activities.

Most often, it will be the owner who is sued by a third party; however, there is no legal impediment to a third party selecting another participant — for example, the constructor — to pursue for recovery.

How should this exposure be dealt with? Some case studies provide alternative approaches adopted by alliances.

Two case studies

Road project, Brisbane

The project has a significant interface with a railway station and adjacent track. Queensland Rail (QR) will not agree to grant track possessions and overhead isolations unless it receives an indemnity for any loss it suffers during construction activities, including disruption to its network.

The project owner has given QR the appropriate indemnity and the alliance has agreed to absorb, as alliance costs, any amount the owner pays to QR pursuant to the indemnity. In order to make that commitment, the alliance first assessed the risk and how it would be managed, and allocated an appropriate contingency allowance in the TCE for the risk.

Rail alliance, SE Queensland

The alliance is delivering a rail project for QR in South East Queensland, which includes the duplication of several busy lines. QR has a potential exposure to rail haulage customers and other corridor users for disruption to the operating rail network.

If the alliance were to absorb this exposure as an alliance cost, the concomitant risk allowances built in to the TCE would have been significant. Accordingly, QR elected to solely absorb the risk of those third-party claims.

Either solution (or indeed neither solution) may be appropriate for different projects. The important message is that the issue should be openly discussed and an aligned position reached.

In that context, the possible impact of proportionate liability legislation should not be overlooked.

Proportionate liability legislation

Proportionate liability legislation[2] has been enacted in all Australian states. The legislation is primarily directed to overcoming the perceived unfairness of the consequences of joint and several liability.

The objective of the legislation is to apportion responsibility for property damage or economic loss (including consequential losses) suffered by a claimant between the responsible parties. For example, the key section of the Queensland legislation is s 31 of the *Civil Liability Act 2003*, which provides:

> In any proceeding involving an apportionable claim … the liability of a defendant who is a concurrent wrongdoer in relation to the claim is limited to the amount reflecting that proportion of the loss or damage claimed that the court considers just and equitable having regard to the extent of the defendant's responsibility for the loss or damage …

The principle contained in s 31 applies where:

- legal proceedings have been commenced by a party which has suffered property damage or economic loss;
- the claim in the proceedings arises out of a breach of a duty of care by the defendant;[3] and
- the court considers that more than one party is 'responsible' for the property damage or economic loss (including a party which may not have been joined as a defendant to the court proceedings).[4]

The Queensland legislation specifically prohibits any attempt, in a contract, to exclude or prevent the operation of the legislation.[5] So, for example, if a contract provides an unqualified indemnity in relation to property damage or economic loss, the liability of a party pursuant to that indemnity will still be read subject to the proportionate liability provisions in the legislation.

Unfortunately, the legislation that has been enacted is anything but 'uniform'. There are significant (and, frankly, illogical) differences in terminology, structure and effect between the various state Acts.

In Queensland, one confusing aspect of the legislation is the terminology used. Although s 31 applies to a claim which is based on a breach of a duty of care (that is, a legal liability), the apportionment to be conducted by the court is on the basis of 'responsibility', not legal liability.

This leaves open the possibility that a plaintiff might be denied full recovery from a defendant because of an apportionment against a party who is responsible, but who has no legal liability to the plaintiff and cannot be sued.

Another confusing aspect is whether the legislation will apply where a claim for breach of a contract term (that is, failure to comply with a specification) is made rather than a claim for breach of a duty of care. The conservative view is that, if a claim can be construed as being based on a breach of a duty of care, the legislation will apply.

Application to third-party claims

As recorded above, most alliancing agreements include a carve-out to the no-blame principle which requires each participant to fully indemnify the other participants with respect to their proportionate liability for third-party personal injury and property damage claims. Each indemnity is usually limited to the insurance available to the relevant party. The intention of these clauses is to enable each party to have access to public liability insurance maintained by each other party to the alliance.

The proportionate liability legislation is consistent with the operation of these clauses and will enable a court to allocate responsibility between the alliance participants for property damage suffered by a third party. Of course, the court's findings are not restricted by the availability of insurance to any party.

Similarly, the legislation will enable apportionment between participants (and other 'responsible' parties) of financial losses suffered by a plaintiff. So, even if the alliance agreement does not specifically address the risk of those claims, the legislation will automatically apportion the risk.

It may also be the case that the legislation will override any different allocation of the risk contained in the alliance agreement. So, for example, where the owner agrees to accept the full risk of these claims by providing the

others with an indemnity, the legislation will negate the effect of that agreement.

Only time will tell whether the courts will give the legislation a literal interpretation, where to do so cuts directly across the commercial agreement on risk allocation voluntarily reached by parties to a contract.

Owner participant losses

Claim against a participant

The effect of a no-blame clause is that each participant releases each other participant from any liability which arises out of alliance activities (subject only to wilful default, the indemnity in relation to third-party claims discussed above and the indemnity in relation to claims by workers).

Accordingly, an owner participant has no claim against any alliance participant in the event that it suffers loss as the result of negligence in carrying out alliance activities and the legislation is not triggered. However, the participants can share the collective responsibility for the rectification of negligent work through the insertion of a three-limb compensation model and the operation of a pain/gain mechanism in limb three of the compensation framework.

Claim against a third party

An owner participant may seek to recover property damage loss and economic losses from a third party. In those circumstances, the proportionate liability legislation may enable the third party to partially avoid liability to the owner by establishing the *responsibility* of a non-owner participant for some part of the loss that has been suffered by the owner participant (even though there is no legal liability for the loss).

In that circumstance, the responsible participant will have the protection of the no-blame clause. Accordingly, that participant's proportionate share of the loss will not be recoverable by an owner participant from any party.

A worked example might help illustrate the point:

- pipe supplied by a subcontractor fails because the pipe supplied was defective *and* the subsequent protection and storage of it by the alliance was inadequate;
- the rectification costs are $100,000;
- a court finds the pipe supplier 70 per cent responsible and the constructor participant 30 per cent responsible;
- the owner will be able to recover $70,000 from the supplier; and
- the remaining $30,000 will be taken up as a reimbursable cost without adjustment to the TCE.

Conclusion

There is no right or wrong way to deal with potential exposure of an alliance to claims from third parties. However, it is critical that those risks are identified, assessed and transparently dealt with in the alliance agreement. A robust alliance depends on a full understanding by all participants of their own risk profiles. ●

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Endnotes

1. This example comes from the *Project Alliancing Practitioners' Guide* (April 2006) published by the Victorian Government, available at <www.dtf.vic.gov.au/DTF/RWP323.nsf/0/dff461e4c4547280ca256d2b000813ef/$FILE/2Complete%20Project%20Alliance%20Guide.pdf>.

2. For example, *Civil Liability Act 2003* (Qld), *Civil Liability Act 2002* (NSW), *Wrongs Act 1958* (Vic), *Civil Law (Wrongs) Act 2002* (ACT).

3. *Civil Liability Act 2003* (Qld), s 28(1)(a). Other states require failure to take reasonable care, rather than a breach of a duty of care: *Civil Liability Act 2002* (NSW), s 34(1)(a); *Wrongs Act 1958* (Vic), s 24AF(1)(a); *Civil Law (Wrongs) Act 2002* (ACT), s 107B(1)(a).

4. *Civil Liability Act 2003* (Qld), s 31(3); *Civil Liability Act 2002* (NSW), s 35(3); *Civil Law (Wrongs) Act 2002* (ACT), s 107F(4). Compare with *Wrongs Act 1958* (Vic), s 24AI(3), which states that regard is not to be had to comparative responsibility of a party who is not a party to the proceedings unless that person is dead, or is a company which has been wound-up.

5. *Civil Liability Act 2003* (Qld), s 7(3); *Civil Liability Act 2002* (NSW), s 3A(2). Legislation in most other states is silent on the issue. The inference to be drawn is that the legislation will override contract provisions.

Treatment options for risks in construction, civil and mining projects

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Due to the various natures of risks which may be encountered in a major project and the differing weights which may attach to their consequences (and the differing 'treatments' which they may entail), it is not uncommon for parties to seek to identify these risks under headings or categories. This can include attempts to break the risks down into commercial (business or project prerequisite and sustainability) risks, construction (and/or operational) risks and third-party (act of God/government) risks — often each with their overlay of 'legal risks'. In this writer's view, one of the dangers of slavishly adopting such an approach is that it can tend to reinforce an assumed allocation of risk dependent upon the project delivery method being proposed and the respective interests of the various stakeholders.

By way of example, a contractor assessing the risks involved in bidding on a straightforward 'construct only' commercial office tower project may assume that so-called 'project risks', such as the availability of requisite planning approvals or the principal's financing, are matters solely the concern of the principal and, accordingly, focus on so-called 'construction risks', such as the impact of latent conditions, risks of delay and so on. While contractors, principals and financiers will, however, each attach varying levels of importance to various risks, a consideration of the totality of risks which may be encountered is essential in order to determine their impact and 'knock on' effect.

Accordingly, it is suggested that it is wise for each of the stakeholders to consider each and every risk which they identify as being relevant to the project as a whole, and thereafter seek to categorise those risks by the manner in which they are proposed to be 'treated', rather than seeking to 'fit' risks into general categories or seek to allocate them at the outset to the respective stakeholders as matters of concern only for the other project participants.

Where dealing with negative outcomes from risks identified and having to treat those risks in the context of a more traditional contract structure, risk mitigation is called into play, this being the process of finding solutions to counter risks. Instead of simply pricing for risks, there are other opportunities for mitigating risks, including:

- risk elimination (for example, not proceeding or proceeding on a different basis);
- risk reduction (for example, by undertaking further investigations/due diligence);
- risk transference (for example, by legal, contractual and insurance); and
- risk retention (for example, self-insurance, bearing a large deductible and internal management of risk).[1]

Often these mitigation strategies, particularly risk transference, are given effect contractually via the use of such means as contractual exclusions, limitations of liability, indemnity clauses, risk transference, guarantees, performance bonds and insertion of a risk premium.

Hypothetical case studies

The application of risk mitigation principles is best demonstrated in the context of a hypothetical contractor's response to two hypothetical projects, the first being a building project under a design and construction agreement and the second being a joint civil and mining project.

In these hypothetical case studies, the context in which the contractor undertakes a risk assessment at the tender phase will be in accordance with corporate limits documented, for example in tendering guidelines which may also detail limits of liability for key commercial risks. The proposal or tender will then be considered against a number of criteria, such as financial and funding risks, construction performance risks and design risks.

The issues for consideration under the financial and funding risks include payment risk and may also extend to issues such as maintaining positive cash flow through the life of the project; payment for on- and off-site materials; and the possible impact of security of payment legislation.

Construction performance risks, on the other hand, relate to the willingness or otherwise of the contracting party to accept general damages and consequential damages; liquidated damages; the provision of parent company guarantees; the requirement for operating company performance guarantees; guarantees for long-term performance of materials or equipment; and industrial relations risk.

In relation to design risks, a contractor may be asked to accept responsibility for process design and for guaranteeing the outputs from a plant or facility; it may be asked to assume fit-for-purpose obligations under a design and construct regime; or it may be asked to accept the risk of achieving development approval for a project.

In each instance, the tender will be gauged against the criteria outlined, and if what the contractor is being asked to assume falls outside of those criteria, then that risk will need to be 'treated' — that is, negotiated or transferred to another party.

Having conducted such a review and proposed optimal methods for

'treating' the risk, ordinarily a number of key 'threshold' risks emerge which require special consideration as the viability of the project (or at least the contractor's involvement in the project) may become very much dependent upon the willingness to either assume, manage or transfer those risks.

Case study 1: hypothetical design and construct building contract

In this study, after careful analysis and evaluation, the following key risks have emerged.

- ***Risk: delay in award of tender/ access to site*** — The contractor is required to submit a tender, which is to remain open for acceptance for a period of three months. Tender prices are to remain firm and are not to be subject to adjustment up to completion, and no adjustment is to be made to the tender price should commencement on site be delayed beyond the period of three months from acceptance of the tender.

  Treatment — The contractor can address this risk by requiring the ability to claim escalation if access to the site is not available within a certain timeframe or, alternatively, can make its tender conditional upon a 'sunset date', after which it has an ability to renegotiate its fixed lump-sum price.
- ***Risk: site conditions*** — The contract requires the contractor to accept full risk of all site conditions. The principal takes no responsibility for the accuracy or completeness of any information which has been provided to the contractor by the principal and any reliance on such information is said to be at the contractor's own risk.

  Treatment — The contractor's alternatives are either to accept the risk and rely upon the site information provided by the principal or, alternatively, to ensure that it has an opportunity to undertake its own investigations as to the site and satisfy itself in relation to all site conditions which may impact upon the works. It also has the option of seeking to qualify its tender and negotiate provisions in relation to latent conditions which afford itself acceptable rights of recovery in the event that site conditions differ from those understood by the parties.
- ***Risk: design responsibility*** — The contractor is required to accept the risk of the design of the project and agrees to take a novation of consultancy agreements already in place between the principal/developer and the existing design consultants. The contractor is to accept responsibility for the designs prepared by the consultants prior to their novation to the contractor and under its contract it also provides a fitness-for-purpose warranty.

  Treatment — The contractor can qualify its tender by only accepting responsibility for the designs prepared after its involvement in the project, or can ensure that it has reviewed the designs prepared by the consultants prior to the date of novation and is satisfied with them. In relation to the fitness for purpose obligation, the contractor should ensure that the statement of purpose uses clear, objective and measurable terms.
- ***Risk: ambiguities in documentation*** — The contractor is asked to assume the risk of ambiguities in the project brief and for any error in or between the design documents arising before or after the date of the agreement. There may be errors between the design documents produced prior to

> The contractor can qualify its tender by only accepting responsibility for the designs prepared after its involvement in the project …

novation and those produced subsequent to novation, by the same or different consultants.
Treatment — If this risk is to be accepted, a thorough review of all documents will be required and the contractor will need to ensure that the consultancy agreements allow the contractor to recover any loss it suffers arising out of defective design documents prepared by the consultants prior to their novation.

- ***Risk: extensions of time*** — The circumstances in which the contractor may be entitled to an extension of time are limited and the question of whether the superintendent may take into account any float built into the contractor's program is unclear. The contractor is not entitled to a proportional extension of time for concurrent delays and its entitlement to an extension of time in respect of changes in legislative requirements is also unclear.
  Treatment — If the contractor is to accept this risk, it needs to consider any exposure it may have for either general or liquidated damages in the event of late completion and also its ability under its program to accelerate the works to complete on time in the event that it is delayed. In either event, it will wish to include an allowance in its tender in respect of this risk. More likely, it will wish to clarify the circumstances in which it is entitled to an extension of time (with or without the right to claim additional costs), particularly in relation to neutral events of delay.
- ***Risk: interface risk, fit-out works*** — Under the contract, the contractor may be required to undertake fit-out works for tenants (by way of a variation to the contract), or tenants may be entitled to engage their own fit-out contractor in which the contractor is responsible for coordinating the fit-out works with the contractor's own works. The contractor is not eligible for any extension of time or increase to the contract sum in respect of this.
  Treatment — This interface risk between the tenants' contractors and the contractor is one in respect of which the contractor would wish either to make provision for extension of time or disruption to its own works or, alternatively, to seek to build in a contingency. The contractor would wish to ensure that it was not accepting the risk of coordinating other contractors, or the risk of the failure of a tenant's design to comply with the principal's design and construction requirements.

Case study 2: hypothetical joint mining and civil project

In this study, after careful analysis and evaluation, the following key risks have emerged.

- ***Risk: mining lease*** — The project is contingent upon the principal obtaining a new mining lease, and the date of the lease being granted is not certain. In the meantime, the contractor is expected to expend resources towards the project and to pre-mobilise. The project cannot proceed if the lease is not granted.
  Treatment — This risk can be adequately addressed in the contractor's response, so that in the event of delay in issuing the mining lease, the contractor can review its ability to meet time and milestone achievements stated in the tender documents, and review pricing if necessary. The contractor will also need to propose a basis for calculation and recovery of its costs in the event that mining lease approval is not forthcoming by a certain date.
- ***Risk: purchase of fleet*** — In order to put itself in the best position to be awarded the contract/s and achieve or better the project milestones, the contractor will be required to commit to acquiring a fleet prior to entry into a firm contract with the client.
  Treatment — This risk can be treated by preserving to the contractor a right to claim holding and delay costs, and to negotiate an agreement for compensation from the principal, where commitments are made by the contractor pre-contract with the agreement of the client.
- ***Risk: interface risk*** — The project will involve interface between both civil and mining components of the

project, and between the project and the clients' other mining operations.
Treatment — This risk can be addressed by allocation of interface risk to the client if separate contracts are awarded for the civil and mining components; if the contractor is awarded both the civil and mining contract, the interface risk with the mine owner's existing operations can be addressed through careful negotiation of contractual provisions.

- ***Risk: wall design*** — A significant design aspect has arisen in relation to a wall to protect against water inundation of the mine pit and whether or not a water-impervious cut-off wall needs to be constructed.
  Treatment — After investigating the feasibility of the risk of water inundation of the mine pit being met by the contractor's insurer, the risk can be addressed by specific allocation of the risk to the client, as ultimately whether to incur the cost of obviating the risk of disruption to the client's operations is an economic decision for the client.
- ***Risk: scope of works/fit for purpose*** — The proposed contract seeks to ensure that design, fit for purpose, whole-of-life and functionality risk is borne by the contractor.
  Treatment — This risk can be addressed on an interim basis by appropriate qualifications and statements contained in a statement of clarifications and departures within the response to the tender proposal which make it clear that this risk allocation will be reviewed based upon the final revised scope of works, and any additional information available at the time of negotiating the contracts.
- ***Risk: cultural heritage*** — Cultural heritage management plans are included with the proposal documents, imposing obligations on the contractor which must be complied with and procedures which must be followed when a cultural heritage discovery is made. Under the proposed contractual allocation of risk, the discovery of a cultural heritage item will entitle the contractor to an extension of time, but will not entitle the contractor to additional costs.
  Treatment — The cultural heritage management plan should be reviewed in detail to ensure that the contractor can comply with the obligations therein set out. As cultural heritage is clearly a concern at this site, the contractor should consider including an allowance in terms of time and money in its proposal for the discovery of an item of cultural heritage.

The role of the adviser

These case studies illustrate the role that an adviser may have, once risks have been identified, in suggesting 'treatment' options for those risks. From a lawyer's perspective, having identified critical areas of concern in relation to risks that a client is being asked to assume and after proposing options for treatment of those risks, it is of course imperative that the ultimate legal documentation accurately reflects the treatment of those risks as agreed between the parties, and accurately reflects the agreed risk allocation.

Pleasingly, there has been a move away from the practice of simply putting the contractual documentation 'in the bottom drawer' once the contract has been negotiated. Rather, parties are now commonly investing the time and effort in preparing working guides or manuals concerning the rights and obligations of the parties to the contracts, cross-referencing these to the relevant contractual provisions and noting time requirements. Provided such a guide is duly observed, this can form a critical feature of day-to-day risk management, particularly having regard to time bars often contained within contracts and the recent impost of security of payment legislation. ●

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Endnote

1. Chinyio E and Fergusson A 'A construction perspective on risk management in public–private partnership' in Akintoye A, Beck M and Hardcastle C (eds) *Public–Private Partnerships — Managing Risks and Opportunities* Blackwell Science, Oxford 2003 p 114.

Casenotes

NEW SOUTH WALES

ABIGROUP CONTRACTORS PTY LTD v SYDNEY CATCHMENT AUTHORITY (NO 3)

[2006] NSWCA 282; BC200608430

This case concerned an appeal to the NSW Court of Appeal by Abigroup Contractors Pty Ltd (the contractor) from a decision of McDougall J on the hearing of cross-applications under Pt 72 r 13 of the *Supreme Court Rules 1970* (NSW) on a referee's report, where the referee had rejected the contractor's claim for relief under s 52 of the *Trade Practices Act 1974* (Cth) (the Act). The principal under the contract was Sydney Water Corporation (the principal).

Facts

The appellant was the contractor for the construction of a spillway at Warragamba Dam. Under the lump-sum contract, the contractor bore all risks, including the possibility that additional work might be required because of site conditions.

The principal had indicated a certain rock level to the contractor. After the contractor had commenced work, the principal became aware of an outlet pipe plan. The contractor argued that knowledge of the plan would have resulted in further enquiries, which would have indicated a substantially lower rock level. Under the contract, the contractor was forced to absorb the cost of the resultant additional excavation, which was approximately $7.5 million.

The contractor claimed that the loss was caused by the principal making a representation that it had no plans of the outlet pipe. The contractor claimed that the principal had engaged in misleading and deceptive conduct contrary to s 52 of the Act. The contractor also claimed that it had undertaken the work in reliance of the principal's misrepresentation, resulting in significantly more work than was allowed for in the contract and was entitled to damages for the cost of the additional work, pursuant to s 82 of the Act.

Issues

- Was there misleading and deceptive conduct under the Act (s 52)?
- Did s 82 of the Act apply where a principal's omission leads a contractor to enter a contract, assume risk and then suffer a loss?
- Was the contractor entitled to claim for delay and consequential damages?

Findings

The leading judgment was given by Beazley JA (with whom Ipp and Tobias JJA agreed). His Honour first dealt with reliance and causation. Section 82 of the Act provides that a person who suffers loss or damage *by conduct of* a person who contravenes the Act may recover that loss or damage. After an extensive review of the authorities on s 82, Beazley JA concluded that there was no 'single immutable test for causation for the purposes of s 82'. Conduct contrary to the Act had been established in the form of the principal stating in the tender documents that there was no plan of an outlet pipe. This was a misleading negative representation because the pipe did in fact exist.

Beazley JA went on to conclude that the traditional 'but for' test (what the contractor would have done but for the misleading negative representation) could not answer the question of whether the contractor suffered loss or damage as a result of the principal's conduct. This is because a strict application of the test would excise the principal's conduct in making the negative misrepresentation to the contractor. The principal would then succeed in its submission that if no representation about the outlet pipe at all had been made, the contractor would still have entered into the contract. There was a plan; its non-disclosure was contravening conduct under the Act; and the contractor did not agree to bear the contractual risk for the excavation.

The critical damages question was whether the contractor was entitled to recover damages for the additional excavation work or only damages on the basis of a loss suffered with reference to the entire contract.

In keeping with the general approach displayed in respect of reliance and causation, Beazley JA reviewed the authorities and concluded that loss could be suffered in different ways. His Honour noted that 'the entitlement to damages under ss 82(1) and 87 is not confined by an enquiry as to the appropriate "measure of damages" as is the case in contract and tort' (at [108]). Therefore a court could utilise a wide variety of approaches to the assessment of damages under s 82, provided the approaches did not result in injustice.

The contractor did not receive the opportunity to make an accurate assessment of the work to be carried out. It relied upon the principal to provide information and had no opportunity to ascertain that the plan existed. The contractor's additional cost for the excavation was recoverable under s 82 because the contractor had been prejudiced in entering into the contract without the knowledge afforded by the plan.

Independently of the claim for damages, the contractor also claimed for delay and consequential damage due to expending additional time in undertaking the additional excavation work. The referee had ruled that completion of the contract works had not been delayed due to the additional excavation work. Beazley JA concluded that the referee had not afforded the delay claim sufficient consideration.

Summary

The contractor was entitled to claim damages for the costs of the additional excavation. Judgment in favour of the contractor was entered into on the issue of damages. The traditional 'but for' test was effectively dispensed with in favour of a more general approach, the limitation being that it caused no injustice to occur. The delay claim was remitted to the Supreme Court for determination. ●

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JOHN HOLLAND PTY LTD v ROADS AND TRAFFIC AUTHORITY OF NEW SOUTH WALES (RTA)

[2006] NSWSC 1202; BC200609447

The decision of Justice Gzell in this case is a further example of the court's narrow construction of what constitutes a denial of natural justice under the *Building and Construction Industry Security of Payment Act 1999* (NSW) (the Act).

Background

John Holland Pty Ltd (John Holland) entered into a contract (the contract) with the Roads and Traffic Authority of NSW (RTA) for the construction of roadworks near Kiama, NSW.

Part of this work became the subject of an adjudication determination by Sean O'Sullivan, under which Mr O'Sullivan rejected a claim by John Holland for a costs adjustment under the contract.

John Holland commenced Supreme Court proceedings challenging the adjudication determination and submitted that Mr O'Sullivan had failed to have regard to John Holland's submissions regarding the applicability of one of the cost adjustment provisions; that this constituted a denial of natural justice; and that as a result the determination was void.

Natural justice

In *Brodyn Pty Ltd t/as Time Cost and Quality v Davenport* (2004) 61 NSWLR 421, Hodgson JA, with the other Court of Appeal judges agreeing, identified three grounds of review of an adjudication determination:

- a failure to comply with five, not necessarily exhaustive, basic and essential requirements — a construction contract to which the Act applies, a payment claim, an adjudication application, reference to an eligible adjudicator and determination in writing by the adjudicator;
- a failure to exercise power under the Act bona fides; and
- a substantial denial of natural justice.

Subsequent decisions in both the Court of Appeal[1] and the Supreme Court[2] have endorsed this position, such that so long as an adjudication determination considers the requirements of s 22(2) of the Act in good faith, then an error in considering the provisions of the Act or the contract does not automatically render an adjudicator's determination void.

This position is to be distinguished from a situation where an adjudicator appeared not to have read the submissions within an adjudication application,[3] or where an adjudicator did not properly consider at all the adjudication response provided.[4] In those circumstances a determination would be void.

Findings

Ultimately, Gzell J held that Mr O'Sullivan had considered the application of the costs adjustment provision and refused the relief sought by John Holland.

It was held that in failing to establish that Mr O'Sullivan did not have regard to its submissions, John Holland failed to establish that a denial of natural justice had occurred. This finding was made in a context where it was submitted that it was unnecessary for the court to consider issues relating to the bona fide exercise of power. Further, this failure by John Holland to establish such a denial was sufficient for Gzell J to conclude that there was also no failure to exercise power in good faith.[5] Unfortunately, this conclusion was not accompanied by any analysis as to why such conduct was not a failure to exercise power in good faith.

In making this finding, Gzell J made some brief comments on the relationship between notions of natural justice and good faith, albeit as obiter. In particular, his Honour referred to the comments of McDougall J in *John Goss Projects Pty Ltd v Leighton Contractors Pty Ltd* [2006] NSWSC 798; BC200606196 and noted the uncertainty surrounding the concept of good faith and the preference of the court 'to deal with most applications on the basis of a denial of natural justice' (at [43]).

Conclusion

Even if an adjudication determination misconstrues submissions within an adjudication application, so as long as those submissions were considered in good faith, such conduct would not, prima facie, constitute the 'substantial denial of natural justice' required for that determination to be void.

While there is considerable overlap between the two grounds of review, 'substantial denial of natural justice' and 'good faith', it appears that the court has a definite preference to decide applications on the basis of a denial of natural justice rather than a lack of good faith.

Therefore, the current confusion surrounding the precise application of natural justice and bona fide grounds of review remains and awaits clarification by the courts. ●

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Endnotes

1. *Minister for Commerce v Contrax Plumbing* (NSW) Pty Ltd [2005] NSWCA 142; BC200502855, at [49] (Hodgson JA), as cited by Gzell J in *Brodyn Pty Ltd v Davenport* (2004) 61 NSWLR 421 at [38].
2. *Brookhollow Pty Ltd v R & R Consultants Pty Ltd* [2006] NSWSC 1; BC200600155, at [57] (Palmer J), as cited by Gzell J in *Brodyn v Davenport*, above note 1, at [39].
3. *Timwin Construction Pty Ltd v Façade Innovations Pty Ltd* [2005] NSWSC 548; BC200503886, at [37] (McDougall J), as cited by Gzell J in *Brodyn v Davenport*, above note 1, at [52].
4. *Reiby Street Apartments Pty Ltd v Winterton Constructions Pty Ltd* [2006] NSWSC 375; BC200602903, at [75] (White J), as cited by Gzell J in *Brodyn v Davenport*, above note 1, at [53], and *Holmwood Holdings Pty Ltd v Halkat Electrical Contractors Pty Ltd* [2005] NSWSC 1129; BC200509449, as cited by Gzell J in *Brodyn v Davenport*, above note 1, at [54].
5. *John Holland*, at [68] (Gzell J).

QUEENSLAND

QUEENSLAND v EPOCA CONSTRUCTIONS PTY LTD

[2006] QSC 324; BC200608850

This decision of the Queensland Supreme Court considered whether judicial review is available for an adjudicator's decision made under the *Building and Construction Industry Payments Act 2004* (Qld) (the Payments Act).

Background

By a contract dated 6 January 2005, the Department of Main Roads (the DMR) engaged Epoca Constructions Pty Ltd (Epoca) for the construction of a bikeway from Fig Tree Pocket to the Brisbane River. Prior to completion, on 22 August 2005, the DMR terminated the contract pursuant to cl 44.4(b) of the general conditions. The grounds for terminating were not an issue in this application.

On 14 November 2005, Epoca issued a payment claim under the Payments Act for $1,698,379.21. The DMR's payment schedule, delivered on 28 November 2005, stated that the DMR was not obliged to make any payments. On 12 December 2005, Epoca made an application for adjudication and the DMR responded in accordance with the Payments Act. The adjudication decision dated 29 December 2005 provided that the DMR pay Epoca $738,293.39.

The DMR filed an originating application under the *Judicial Review Act 1991* (Qld) (the JRA) and obtained an interlocutory injunction restraining Epoca from taking any action to recover the money until the final hearing of the application.

Issues

The key issue to be determined by Philippides J was whether adjudication decisions made by an adjudicator under the Payments Act are subject to judicial review under the JRA.

The court also considered the grounds of review, including that the adjudicator:

- failed to consider the provisions of the Payments Act as required by s 26(2)(a);
- failed to consider the terms of the contract as required by s 26(2)(b); and
- erred in the construction of the terms of the contract.

Decision

Applicability of the Judicial Review Act to the Payments Act

The court rejected Epoca's submission that judicial review is excluded from the Payments Act by necessary implication. Section 18 of the JRA provides that the Act does not apply to any legislation listed in Sch 1 Pt 2. Philippides J considered s 18 to be determinative of the availability of review (at [26]):

> ... given that the JRA specifically provides a mechanism by s 18 whereby legislation may be excluded from the scope of rights of review set up by the JRA, one would expect a legislative intention to exclude judicial review to be indicated in accordance with that mechanism.

The Payments Act is not included in this list and there is no provision in the Payments Act excluding the operation of the JRA. Accordingly, the court could not adopt a purposive interpretation of the Payments Act or conclude that review is excluded by necessary implication (as submitted by Epoca). Philippides J affirmed a similar decision in *J J McDonald & Sons Engineering Pty Ltd v Gall* [2005] QSC 305; BC200509343, where it was held that this conclusion is unavoidable, despite concerns that it will undermine the purpose of the Payments Act to provide prompt periodic payments to contractors.

This finding represents an important divergence from the NSW position. In the decision of *Brodyn Pty Ltd t/as Time Cost and Quality v Davenport* (2004) 61 NSWLR 421, the NSW Court of Appeal found that review of an adjudicator's decision made under the corresponding payments legislation is limited to circumstances where the determination is invalid for failing to meet the essential requirements of a determination. Review on the basis of

non-jurisdictional errors of law could not be allowed because it would compromise the expediency and finality contemplated by the Act. Philippides J determined that this reasoning was not applicable in Queensland because NSW has not enacted corresponding judicial review legislation.

A decision of 'an administrative character'

Epoca conceded that an adjudicator's decision is a 'decision' that is made 'under an enactment', but argued that such a decision is not of 'an administrative character' and thus not reviewable under Pt 3 of the JRA. The court did not attempt to define 'administrative character', but rather proceeded on a basis that distinguished the adjudicator's decision from an exercise of judicial power. Philippides J considered that the provisions of the Payments Act are such that an adjudicator's decision lacks several key features of a judicial decision, namely the following.

- An adjudication is not conclusive, as s 100 preserves parties' right of recourse to the courts to determine the ultimate entitlement to the payment.
- An adjudicator's decision is not made in accordance with the judicial process, as there are no provisions to allow an adjudicator to call and cross-examine witnesses. Although s 25(4) allows an adjudicator to call a conference of the parties, it must be held informally and without legal representation.
- The requirements for holding an adjudication qualification as prescribed in s 60 do not include legal qualifications.

Accordingly, the court concluded that an adjudicator's decision is one of 'an administrative character' and reviewable under Pt 3 of the JRA. On this basis, the court declined to exercise its discretion under the JRA to dismiss the application without a consideration of the merits.

Grounds of review

The first ground of review submitted by the DMR was that the adjudicator erred in law by failing to consider the provisions of the Payments Act. In the payment schedule, the DMR withheld payment for a portion of the claim relating to noise barriers for the reason that there was 'no work done'. However, contrary to s 24(4) of the Payments Act, the DMR subsequently changed this reason in its adjudication response. Because of s 24(4), the adjudicator declined to consider the DMR's changed reason and determined that the DMR had no valid reason for withholding payment of this amount. The DMR submitted that because s 24(4) prohibited consideration of its reasons in the adjudication response, the adjudicator was required to assess the work independently and not simply accept Epoca's uncontested valuation.

An adjudicator's decision is not made in accordance with the judicial process, as there are no provisions to allow an adjudicator to call and cross-examine witnesses.

Philippides J disagreed on the basis that the adjudicator was entitled to accept the valuation put forward by Epoca and had adequately revealed his reasons for reaching his decision. In these circumstances, her Honour refused to set aside the decision on this claim.

The second ground of review concerned amounts allowed by the adjudicator in respect of agreements said to have been reached post-termination. The DMR argued that the adjudicator was not entitled to value work done under separate post-termination agreements by reference to the valuations in the payment schedule. Again, the court disagreed and found that Epoca was able to claim these payments under the payments schedule because it was entitled to 'progress payments' for 'construction work' under contracts that were each a 'construction contract' as defined by the Payments Act.

The third ground of review was that the adjudicator failed to have regard to the terms of the contract. This submission related primarily to concrete pavement and electrical conduits that the DMR claimed did not meet the requirements specified in the contract. The DMR contended that cl 42.1 of the contract provided for the calculation of payments and that payments were conditional on the works being in conformance with the contract. However, the DMR's payment schedule provided few details of the nature of the non-conformities and no explanation for the DMR's assertion that no payment was owing for the pavement and that only 50 per cent of the agreed payment was owed for the conduits. The court held that the adjudicator was entitled to determine the issue of conformity on the material before him and conclude that the full amounts claimed by Epoca be paid.

The fourth ground of review was that it was submitted by the DMR that the adjudicator failed to give consideration to relevant clauses in the contract providing for withholding of retention moneys. While the court noted that nowhere in his decision did the adjudicator consider the withholding of retention moneys, the DMR had not given a reason for withholding payment, nor did it identify the retention moneys in either its payment schedule or its adjudication response. The court concluded that an adjudicator is not required to consider clauses in the contract pertaining to the withholding of retention moneys unless a party raises the matter.

The fifth ground of review was that it was submitted by the DMR that the adjudicator made an error of law by failing to apply provisions of the contract relating to a progressive entitlement and disestablishment entitlement method of payment for site facilities. The contract provided a method for calculating these payments that the adjudicator interpreted as ambiguous, and in any event he was not satisfied that the DMR had correctly calculated the entitlement. The adjudicator therefore allowed Epoca the full lump-sum amount for site facilities. The court identified the proper construction of the payment provision and noted that the adjudicator had not properly applied the provision. Accordingly, the court set aside that portion of the decision.

The sixth ground of review was that the adjudicator made an error of law in the construction of cl 42.10 of the contract. The DMR sought to set-off a claim for damages as a result of the termination of the contract under cl 44.4(b). Clause 42.10 permitted the DMR to make a deduction from moneys due to Epoca for 'any claim which the Principal may have against the Contractor':

> (a) whether or not the debt or claim arises by way of damages, debt, restitution or otherwise; and
>
> (b) whether or not the factual basis giving rise to the debt or claim arises out of this Contract or any other contract or is independent of any contract.

The adjudicator interpreted a claim as an 'assertion or a contention' and concluded that:

> An assertion or a contention cannot be deducted from moneys. A claimed amount can be deducted. However, clause 42.10 does not refer to a claimed amount. It refers to 'any claim which the Principal may have against the Contractor'. Clause 42.10 does not presently provide the respondent with any right to withhold payment.

Philippides J considered this interpretation to involve an error of law and held that the DMR was entitled to have deducted from any moneys due to Epoca any claim by way of damages. However, the DMR had in its adjudication submissions asserted that its damages would be 'far in excess of the sums payable under Epoca's contract', but had conceded that it was unable to quantify the amount of the damages and only had an estimate of the same. Philippides J stated that if the DMR was unable to quantify the amount of the claim for damages, then the adjudicator was entitled to decline to act on an unsubstantiated assertion that the amount of the damages exceeded the amount payable to Epoca. Accordingly, the court refused to set aside the adjudicator's decision not allowing the DMR to set-off its damages claim.

The final ground of review was that the adjudicator made a further error of law in the construction of cl 42.10 of the contract, this time in relation to the DMR's claim to a set-off for expenditure it had incurred on a concrete retaining wall, a noise barrier and a bridge balustrade. Philippides J decided that the adjudicator had erred in deciding that these claims for set-off fell within the general damages claim — that is, they were not within the DMR's concession that the claims could not be quantified.

Conclusion

For the reasons stated above, the court set aside the adjudicator's decision which allowed Epoca's claim for site allowances and the decision which did not allow the DMR's claim for set-off for the specified additional costs. The claims for set-off were referred to the adjudicator for further consideration in accordance with cl 42.10 of the contract. ●

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